

IV DAVID RICARDO AND THE CRY FOR FREE TRADE

David Ricardo never attended college. But he delved into economic theory with more competence than any academic. He never formally studied financial markets. Yet he made millions of pounds in the stock market. His powerful mind and practical knowledge so dominated intellectual foes that he could win fiery debates and then dismiss the rival argument, saying that only a university professor would be silly enough to believe it.

One university professor was "silly" enough to disagree with Ricardo. His name was Thomas Robert Malthus. But critics had so viciously slandered Malthus that he actually enjoyed Ricardo's thoughtful attacks. After Shelley and Coleridge, Ricardo's snipes must have seemed more like a serenade. And at least Ricardo agreed with his population principle.

The relationship between Ricardo and Malthus began in the press, when each published essays on currency and trade issues criticizing the other. Malthus finally sent a letter to Ricardo in 1811, suggesting that since "we are *mainly* on the same side of the question, we might supersede the necessity of a long controversy in print . . . by an amicable discussion in private." At almost the same time Ricardo was composing nearly the same note. They met a

few days later and it was the beginning of a lifelong friendship. Before Ricardo's death in 1823, he wrote to Malthus, stating that despite numerous disputes, "I should not like you more than I do if you agreed in opinion with me." Only three people shared in Ricardo's will, and Malthus was one. Later Malthus announced, "I never loved anybody out of my own family so much."

Malthus never knew anybody who was so outside his "family" as Ricardo. Whereas Malthus came from an old English family and took holy orders in the Anglican Church, Ricardo was born the son of a Jewish immigrant in 1772. Abraham Ricardo was one of the twelve "Jew Brokers" permitted to practice as a stockbroker in London. While Malthus received careful tutoring and schooling at Cambridge, Ricardo went to work with his father at fourteen and began to learn intricate financial systems and strategies on the job, so to speak. And he learned well. By his mid-twenties the man with the Midas touch had established his own business and amassed a fortune through stocks, bonds, and real estate investments. The only investment money Malthus ever earned, Ricardo made for him. A primary example of their contrasting acumen occurred during Napoleon's reign. Ricardo had bought some British government stock for himself and Malthus, but after the proclamation of a new French constitution, Malthus grew nervous, fearing that a good turn of events for the French leader would hurt the stock. In tones so timid that they show Malthus better suited for a Church bingo game than the stock market, he requested Ricardo to sell the shares, unless "it is either wrong, or inconvenient to you, and whatever may occur . . . I shall always be sensible of your kindness, and not disposed to repine." Ricardo sold Malthus' shares but held on to his own a bit longer, earning almost double Malthus' premium.¹

Although wealth surrounded Ricardo, he did not read *The Wealth of Nations* until he was twenty-seven and only then by "accident." During a boring vacation in the English resort of Bath, the future leader of classical econom-

ics tripped upon the founder's greatest work. Recall that Adam Smith began *The Wealth of Nations* during a dull stay in France. Since economics seems to owe more to boredom than any other discipline, perhaps students should not complain if their professors occasionally repay the favor or commemorate the founding.

In 1809, Ricardo debuted as an economics writer—with newspaper articles and pamphlets on currency and inflation—to rave reviews. At the urging of James Mill, a political economist and father of philosopher John Stuart Mill, Ricardo entered London's intellectual society, later becoming a member of Malthus' Political Economy Club and of the King of Clubs (a social club). A splendid raconteur and host, Ricardo especially impressed the novelist Maria Edgeworth, who reported having had "a delightful conversation, both on deep and shallow subjects. Mr. Ricardo, with a very composed manner, has a continual life of mind, and starts perpetually a new game in conversation. I never argued or discussed a question with any person who argues more fairly or less for victory and more for truth."²

The son of an immigrant soon became the model English gentleman, wise to the industrial revolution and smart in the drawing room. At the bullying of James Mill, in 1817 Ricardo finally wrote a treatise, *On The Principles of Political Economy and Taxation*, providing a full commentary on Adam Smith as well as contemporary issues. Two years later, and again at Mill's urging, Ricardo won a seat in the House of Commons, where his high-pitched voice rang out for political freedoms and free trade.

A Tricky But Brilliant Theory

We do not know how many members of Parliament actually understood Ricardo, especially his views on trade. This was not because his views were cloudy or he was inarticulate, but because Ricardo tried to argue perhaps

the most complex and counterintuitive principle of economics. Once President Gerald Ford gave a televised speech on the federal budget deficit using a calendar as a visual aid, all carefully rehearsed so that he would not make any embarrassing hand gestures. No modern president would attempt to do what Ricardo tried to do. Unfortunately, the perplexing principle is the key to modern economic understanding. An insolent natural scientist once asked a famous economist to name one economic rule that is not either obvious or unimportant. Ricardo's Law of Comparative Advantage was the immediate response. Regrettably, few politicians then or now can follow the analysis. As a result, quotas, tariffs, and trade wars mar the world's economic history.

Before examining the principle, let us see why Ricardo bothered to explain it. As in Adam Smith's vision, businessmen love to shout about free enterprise at Rotary Club meetings, yet whisper requests for favors into the ears of politicians on Capitol Hill. During Ricardo's time, landowners whispered and waved their wealth at Parliament, securing protection from the import of grain after the Napoleonic Wars. The price of grain had soared during the Wars, partly as a result of Napoleon's embargo, and landowners feared a sudden drop at the onset of peace. On the other side of the aisle sat the rising bourgeoisie, the new businessmen of the Industrial Revolution. Since the bourgeoisie employed laborers, they preferred to see lower prices for food, so they wouldn't be forced to pay higher wages. The landowners won the battle of influence, and in 1815 Parliament passed an act that prohibited imports of grain below a certain price, virtually granting farmers a monopoly. British dictionaries define "corn" as grain such as oats, rye, wheat, and barley. Thus, the acts were called "Corn Laws."

Ricardo saw two futures for Britain: First, as an insular, protectionist island barricaded against foreign goods. Second, as an extroverted trader, acting as the "world's workshop." The choice was critical. For if Britain chose the

former, the self-reliant economy would soon become decrepit. We will first learn why Ricardo preferred the open-door policy and then examine the tricky question of Ricardo's "stationary state."

Recall Adam Smith's absolute advantage trade model. Imagine him espousing his theory and insulting the French by saying, "We don't like them. They eat frogs. And I had a tedious time in Toulouse. But if they can make wine cheaper than we can, we should toast them and drink their wine. If they cannot make wine more cheaply, let's just snicker at them across the English Channel." A logical, intuitively correct statement.

To understand Ricardo's response, imagine the old television series "Gilligan's Island." Hapless, hopelessly clumsy Gilligan is washed ashore along with the competent, self-assured skipper. Two tasks must be done—fishing and building shelter. Assume that the skipper can catch a fish dinner in 10 hours and build a thatched hut in 20, and that Gilligan usually hooks himself and takes 15 hours to catch fish and 45 hours to build a hut. By Adam Smith's logic, the skipper should move as far away from Gilligan as possible, building and fishing on his own, since he outperforms Gilligan in everything. But economists still shudder with reverence when Ricardo shows that the skipper should split the chores with Gilligan!

Let's first calculate how many fish dinners and huts they could build on their own, spending half their time fishing, the other half building. Assume that during a year, the skipper will work a total of 2,000 hours, and his younger first mate Gilligan is ordered to work 3,600. If the skipper spends 1,000 hours on fishing, he will garner 100 fish dinners; and 1,000 hours of hut building by him will produce 50 huts. Gilligan's 1,800 hours of fishing will bring 120 dinners; and 1,800 hours of hut building will make 40 huts. So the total number of dinners on the island is 220, eaten in the comfort of 90 huts.

What happens if they specialize? If the skipper spends all his time on huts, he will construct 100; if Gilligan

concentrates on fish, he will return with 240 fish dinners. Thus, the island has increased output dramatically just by specializing, even though Gilligan was far less competent at both tasks!

Imagine Ricardo responding to Smith's hypothetical insult of the French by saying "I dislike the French as much as Adam Smith did. But I do not snicker at them just because they cannot do anything as cheaply as we can. I would trade with them despite their inferiority."

The next key question is: how do we know what to specialize in? Let us return to the island. Since it takes the skipper twice as long to erect a hut as it does to catch dinner, he gives up two dinners every time he builds a hut. But Gilligan, who takes three times longer to build a hut than to catch dinner, gives up three dinners every time he builds a hut. Since building huts is a smaller sacrifice for the skipper, he should build huts. Ricardo showed that people and countries should specialize in whatever leads them to give up the least. This is their "comparative advantage." And the sacrifice they make by not producing a good is their "opportunity cost." Thus, specialization is determined by whoever has the lower opportunity cost.³

The point of Ricardo's analysis: free trade makes it possible for households to consume more goods *regardless* of whether trading partners are more or less economically advanced. The point of Ricardo's Corn Laws position: If French farmers are willing to feed us for less than it would "cost" us to feed ourselves, let us eat French food and spend our time doing something else.

The Battle Against Protectionists

If Santa Claus begins airlifting cakes, cookies, and clothing by reindeer, should we shoot Rudolph out of the sky because we bake and sew ourselves? The problem confronting Ricardo and all "free traders" is that bakers and